National Credit Union Administration

Federal Credit Union Handbook

Prepared by the Office of
Examination and Insurance

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Foreword

The Federal Credit Union Handbook is intended to assist the board of directors in conducting the credit union's affairs. Since the Federal Credit Union Handbook covers a wide range of subjects, its contents should also prove useful to credit union employees and committee members in carrying out their duties and responsibilities.

The Handbook is intended as a general reference. Accordingly, the reader is encouraged to review and become familiar with other National Credit Union Administration publications and the laws and regulations that apply to federal credit unions.

Preface

In the early twentieth century, credit needs of the urban working classes in the United States were largely neglected by established financial institutions. For the most part, the average worker had nowhere to turn except to the usurious money lenders of the day. This growing dependency complicated the economic life of the average consumer and gave rise to the development and formation of a cooperative credit system in the United States, an idea originating in Europe and imported to North America in 1900. In 1908, the first legally chartered cooperative credit society was established in Manchester, New Hampshire by a special act of the state's legislature. The following year, the first complete credit union act, the Massachusetts Credit Union Act, became law in Massachusetts. By 1933, enactment of state laws permitting formation of credit unions had been largely accomplished. In 1934, the Federal Credit Union Act was signed into law, giving further impetus to the movement.

The post World War II era gave rise to an enormous appetite for consumer goods and an attendant need for consumer credit. Credit unions met this need to an increasing extent and expanded rapidly. The credit union system became a recognized social and economic force in the United States. By the end of 1998, over 73.5 million people were members of credit unions.

Credit unions differ from other financial institutions in that they are cooperative associations organized to serve members with a common bond of employment, association, or residence. Another characteristic that sets them apart is voluntarism. The founders of the movement believed that the organization and operation of credit unions should be accomplished chiefly by volunteers.

Credit unions are organized under a dual-chartering system of federal and state laws. Both types are characteristically similar in purpose: to promote thrift among their members and to create for them a source of credit at reasonable interest rates.

Part I
Federal Credit Unions

A federal credit union is a cooperative non-profit financial institution organized to provide its members with a place to save and a source of loans at reasonable rates. It is a corporation chartered under the Federal Credit Union Act to serve groups having a common bond of occupation or association, or groups within a well-defined, local neighborhood, community, or rural district. More information about federal credit union organization and the chartering policies of the National Credit Union Administration (NCUA) may be obtained from NCUA's regional offices.

The Federal Credit Union Act

The Federal Credit Union Act provides for the chartering and supervision of federal credit unions by NCUAand the insuring of member accounts of federal and state-chartered credit unions through the National Credit Union Share Insurance Fund (NCUSIF).

Section 107 of the Federal Credit Union Act specifically defines a federal credit union's direct (express) powers. They include, for example, the power to accept share deposits, make loans to members, and borrow funds. Section 107 of the Act also confers indirect (incidental) powers upon a federal credit union. These are powers which are considered necessary to enable a federal credit union to carry out the business for which it was chartered. The Act does not specifically define indirect powers; the board of directors should therefore satisfy itself that any activity not specifically authorized by the Act or NCUARules and Regulations is clearly within the credit union's indirect powers. If the board of directors has any questions with respect to the proposed activity, it should seek legal advice or consult the appropriate NCUA regional director.

Since 1934, various amendments to the Federal Credit Union Act have greatly expanded the ability of federal credit unions to meet their members' financial needs; however, the basic purposes of a federal credit union, as stated in the Act, remain unchanged.

National Credit Union Administration

The National Credit Union Administration is in the Executive Branch of the Federal Government. It receives no appropriations and operates solely from monies it receives from insured credit unions. NCUAis headquartered in Alexandria, Virginia, but it operates on a highly decentralized basis through six regional offices which are located in Albany, New York; Alexandria, Virginia; Atlanta, Georgia; Chicago, Illinois; Austin, Texas; and Concord, California. More than 80 percent of the Agency's employees are assigned to the regions. Each regional office is managed by a regional director who reports to the Executive Director. The NCUABoard consists of a Chairman and two Board Members, each appointed by the President and confirmed by the Senate. The NCUABoard and its headquarters staff provide policy direction and administrative support to the regional offices.

NCUARules and Regulations

Under authority of the Federal Credit Union Act, NCUAprescribes rules and regulations for the organization and operation of federal credit unions. All rules and regulations are published in the National Credit Union Administration Rules and Regulations.

It is NCUA's policy to ensure that its regulations impose only minimal burdens on credit unions, consumers, and the public; are appropriate for the size of the financial institutions regulated by the Agency; and are clear and understandable. No major regulatory changes are made without first affording federally insured credit unions and other interested persons the opportunity to comment. Credit union officials are encouraged to participate in the regulatory process and submit their comments to NCUA. For further information about the Agency's policies for the promulgation of rules, see NCUA Interpretive Ruling and Policy Statement No. 87-2, dated September 18, 1987. Once finalized, the rules and regulations are officially codified in Chapter VII, Title 12 of the Code of Federal Regulations and have the force of law similar to the requirements of the Federal Credit Union Act.

Charter

After an organization certificate filed by the subscribers of a proposed federal credit union is approved by NCUA, the document becomes the credit union's official charter. Among other things, the charter includes the official name of the credit union and defines its field of membership.

A federal credit union may find it necessary from time to time to make changes in its name or field of membership, requiring an amendment to the charter. Applications for approval of such amendments should be made to the regional director. Further information on charter amendment procedures may be obtained from NCUA's regional offices or see NCUA's *Chartering and Field of Membership Manual* (NCUA8007).

Bylaws

NCUAprescribes standard Federal Credit Union Bylaws (NCUA8001) for adoption upon chartering. Once adopted by the board of directors, the standard bylaws become the official bylaws of the credit union.

Standard bylaw amendments may be adopted by the board of directors without further NCUAapproval. Applications for approval of non-standard amendments should be forwarded to the regional director for NCUAconsideration. For further information, see Federal Credit Union Standard Bylaw Amendments and Guidelines (NCUA8001A).

NCUALetters, Regulatory Alerts, Interpretive Rulings, and Accounting Bulletins

NCUApublishes numbered Letters to Credit Unions, Regulatory Alerts, Interpretive Rulings and Policy Statements, and Accounting Bulletins. These deal with a variety of subjects of interest and application to federally insured credit unions. They should be retained in the permanent files for ready reference.

Examinations

The principal method by which NCUA carries out its supervisory responsibility is through on-site supervisory examinations. These examinations are designed to assist the credit union's officials and employees in carrying out their duties and responsibilities.

It is essential that the credit union's officials and employees cooperate fully throughout the examination. This includes making the credit union's books and records readily available to the examiner. With the cooperation of the officials and employees, the examiner will be able to complete the examination more quickly and keep to a minimum any disruption of normal office routine.

It is important to understand that supervisory examinations are not audits. The responsibility for auditing the credit union is placed on the supervisory committee by the Federal Credit Union Act. The examiner's objectives are to determine that the credit union is financially sound and that its operations are being conducted in compliance with applicable laws and regulations.

The examiner will discuss with the appropriate officials and employees any problems or conditions that impair or may impair the soundness of the credit union. The examiner will also assist the officials in developing plans designed to overcome the underlying causes of any current or potential problems. Through conferences with the officials, the examiner will ensure that they understand what must be done to improve operations.

The results of the examination are provided to the credit union in a written report. To derive the greatest benefit from the examination, the board of directors and committee members should review the report carefully. The board is responsible for taking any necessary action, and the supervisory committee has the duty to determine that the board has followed through.

Part II
Organizational Structure and Control

Membership

Eligibility for membership in a federal credit union is limited to the persons and organizations sharing the common bond described in the credit union's field of membership as set forth in Section 5 of its charter. A person becomes a member upon approval of an application for membership, subscription to at least one share and payment of the initial installment thereon, and payment of an entrance fee if required by the board of directors.

The members exercise democratic control of the credit union by attending and participating in regular and special membership meetings, and by electing the board of directors (and credit committee, if the bylaws so provide). Each member is entitled to not more than one vote irrespective of the number of shares owned; and no member may vote by proxy, but a member other than a natural person may vote through a designated agent.

Regular and special meetings of the members are held in accordance with Sections 110, 115, and 118 of the Federal Credit Union Act and Articles V, VI, and X of the bylaws.

A member may be expelled from membership by action of the members or the board of directors as provided for in Section 118 of the Act and Article XVI of the bylaws.

Board of Directors

The board of directors is elected by the members from among their number to provide general direction and control of the credit union, and is required to meet at least once a month. The Act and bylaws require that the board shall consist of an odd number of credit union members, not fewer than 5 nor more than 15. No member of the board may, as such, be compensated.

The board elects the credit union's officers, one of whom may be compensated, from its own number. These officers, whose titles are determined by the board, are the executive officer, one or more assistant executive officers, a financial officer, and a recording officer. The board may employ one or more assistant financial officers, none of whom may also hold office as executive officer or assistant executive officer; and one or more assistant recording officers, none of whom may serve as executive officer, assistant executive officer, or financial officer. The board may also appoint a membership officer, who may not be compensated, to act on applications for membership.

The board of directors appoints the credit union's supervisory committee and, if the bylaws provide, a credit committee or loan officers. The board may also appoint an executive committee of not less than three directors to act for the board and carry out specifically designated functions. No member of the supervisory, credit, or executive committees may be compensated as such.

The board may appoint a management official and one or more assistant management officials, none of whom may be members of the board, unless a standard bylaw amendment is adopted. These employees serve under the supervision of the board or financial officer and may be compensated. The directors may employ and fix the compensation of any other employees they deem necessary to carry out the credit union's operations.

The board may also establish committees from among the members to assist in the management of the credit union. Examples are a budget committee, personnel policies committee, education committee, and delinquent loan committee.

For a full discussion of the board's responsibility for providing sound and effective management of the credit union's operations, refer to Part V, Management, of this Handbook.

The duties and powers of the directors, board officers, and employees are set out in Sections 111, 112, and 113 of the Federal Credit Union Act and Articles VII and VIII of the bylaws. These should be reviewed carefully.

Credit Committee

The Federal Credit Union Act provides that if a federal credit union's bylaws call for a credit committee, the members of the credit union may elect the committee or, if the bylaws so indicate, the board of directors may appoint the committee. In accordance with the bylaws, the committee must be comprised of an odd number of credit union members, not less than 3 nor more than 7. The committee is required to meet at least once a month.

The credit committee has the authority to appoint one or more loan officers, not more than one of whom may serve on the committee. The committee may selectively delegate its powers to a loan officer and set the limits of the delegation. Applications or requests not approved by a loan officer must be acted upon by the credit committee.

If the bylaws do not call for a credit committee, the board of directors will appoint one or more loan officers and authorize them to assume the powers of a credit committee. A member may appeal to the board any application or request denied by a loan officer. Loan officers may be compensated to the extent authorized by the board. The duties and powers of the credit committee and loan officers are discussed in Section 114 of the Act and Article IX of the bylaws. The attention of the committee and loan officers is also directed to the discussion under Credit Services in Part III of this Handbook.

Supervisory Committee

The Federal Credit Union Act and bylaws provide that the board of directors shall appoint a supervisory committee consisting of not less than 3 nor more than 5 credit union members. One of the members of the committee may be a director other than the compensated officer of the board, but no credit committee member or credit union employee may be a member of the committee.

The supervisory committee is an essential part of the credit union's management. Under the Act and bylaws, its major responsibilities are to make an audit at least annually and to verify the accounts of the members with the records of the financial officer at least once every 2 years. The committee is also responsible for reviewing the performance of the officials and employees and making recommendations to the board of directors for improvement in the operations of the credit union.

In order to carry out its responsibilities, but dependent on charter type and asset size, the supervisory committee may employ certified public accountants, public accountants, and other qualified persons to perform auditing, account verification, and clerical work under its supervision. The board of directors provides compensation to persons assisting the supervisory committee, but only the committee has the authority to select, prescribe the duties of, and remove such individuals. See Part 715 of the NCUARules and Regulations for specific requirements.

The members of the supervisory committee are urged to study the *Supervisory Committee Guide for Federal Credit Unions* (NCUA8023) for assistance in carrying out their important function.

Federal Credit Union Organization Chart

Members

Responsibilities:

1. Elect board of directors and credit committee.
2. Participate in membership meetings.
3. Promote participation in and use of credit union services.
4. Repay loans as agreed.
5. Remove any official for cause.
6. Expel members for cause.

Credit Committee

Responsibilities:

1. Meet at least monthly and maintain minutes.
2. Appoint loan officer(s) as needed and delegate authority.
3. Counsel members in wise use of credit.
4. Maintain confidential relations with members.
5. Act on applications for loans and lines of credit.
6. Act on requests for release of collateral.
7. Act on requests for extensions and refinancing of loans.
8. Act on requests denied by loan officer(s).
9. Make annual report to members.

Board of Directors

Responsibilities:

1. Maintain general direction and control.
2. Meet at least monthly and maintain minutes.
3. Establish operating policies and procedures.
4. Elect board officers and fix compensation of specified officer.
5. If bylaws provide, appoint credit committee or loan officer(s).
6. Appoint supervisory committee.
7. Appoint membership officer, executive and other committees.
8. Hire, fix duties and compensation of employees and set personnel policies.
9. Maintain confidential relations with members.
10. Act on membership applications.
11. Determine classes of accounts and fix maximum individual share limit, when appropriate.
12. Fix loan policies regarding loan maximums, interest rate, maturity, and security.
13. Establish collection policies and procedures and fix late charges.
14. Designate depository for funds.
15. Authorize investments and borrowing.
16. Declare dividends and interest refunds.
17. Determine surety bond needs at least annually.
18. Authorize necessary insurance.
19. Provide necessary service facilities.
20. Act on loans to directors, credit and supervisory committee members in excess of $20,000.
21. Appoint a security officer and supervise security program.
22. Establish a records preservation program.
23. Request approval of charter and non-standard bylaw amendments.
24. Plan and hold annual meeting, report to members, and maintain minutes.

Supervisory Committee

Responsibilities:

1. Make or cause to be made audits at least annually.
2. Submit audit reports to the board of directors and summaries to members at annual meetings.
3. Verify with members their account balances at least once every 2 years.
4. Maintain confidential relations with members.
5. Suspend directors, officers, or credit committee members for cause.
6. Call special membership meetings for cause.
7. Maintain committee's records.
8. Request board approval for compensation of clerical and auditing assistance.

Note: The board of directors may adopt a bylaw amendment eliminating the credit committee and vesting the committee's authority in one or more loan officers by the board.

PART III
Member Services

Thrift Services

The promotion of thrift is one of a federal credit union's basic purposes and has as its objective the improvement of the economic and social conditions of the members.

In encouraging the members to save, a credit union may offer a variety of share accounts. Generally, share types fall into the broad categories of regular shares, share draft, share certificate, money market, and retirement plan accounts. Other less commonly used accounts include escrow, nonmember, and public unit accounts. A federal credit union must offer its members a regular share account, either as a separate account or in combination with any of the other available accounts.

Share accounts and share certificate accounts are the credit union's primary source of funds. A discussion of the types of share accounts and applicable requirements will be found in Section 701.35 of NCUARules and Regulations.

Credit Services

Loans to members represent a federal credit union's major investment. The board of directors has the responsibility for setting written loan policies and is afforded considerable flexibility by Section 107(5) of the Federal Credit Union Act and Section 701.21 of NCUARules and Regulations on matters such as loan maturity, rate of interest, and security.

The provisions of the Act and NCUAregulations as well as of consumer laws and regulations (see Part VII for a discussion of consumer laws and regulations) should be understood and followed by the board and credit committee/loan officers in their respective policymaking and credit approval roles.

The granting of loans by the credit committee and loan officers involves the three "C's" of credit. The three "C's" are Character, Capacity to repay, and Collateral available to the credit union should the borrower fail to repay as agreed.

A determination of character involves the development of information relating to the applicant's credit history. This may be obtained from other financial institutions and grantors of credit and from credit bureaus. The applicant's record of repayment of previous loans from the credit union is also relevant.

In determining an applicant's capacity to repay, the credit committee or loan officer should carefully examine income, debts, debt payments, and living expenses. After debt payments and living expenses are taken into account, the applicant's income should be adequate to retire the loan in accordance with the agreed upon terms.

Collateral is pledged security to which the credit union can turn for collection if the borrower defaults. The repayment schedule should provide that the loan balance is reduced more quickly than the collateral depreciates. The collateral should be readily convertible to cash. If the security is a comaker, that individual should have the ability to repay in the case of default.

A federal credit union may grant unsecured and secured loans. Unsecured loans are consumer-type loans, usually relatively small, traditionally offered for various purposes incidental to the members'needs. Secured loans extend credit with a security interest in personal or real property of tangible value. The security may also be an endorsement by another person who agrees to repay if the borrower fails to do so. Comaker loans, share-secured loans, and automobile loans are common types of secured loans. Of particular significance are the following other kinds of secured loans:

Home Equity Loans. A home equity loan is designed to permit a borrower to make use of equity in the member's residence to increase borrowing capacity. It is usually secured by either a first or second mortgage on the residence. The maturity of a second mortgage loan is limited to 15 years or such longer period as may be permitted by the NCUABoard.

Residential Real Estate Loans. A federal credit union may grant a residential real estate loan on a one-to-four-family dwelling, including an individual cooperative unit, that is or will be the principal residence of the borrower. Maturity is limited to 40 years or such longer period as may be permitted by NCUAon a case-by-case basis. The loan must be secured by a perfected first lien on the dwelling or a perfected first security interest in a residential cooperative unit in favor of the credit union.

A sound lending policy dictates that written appraisals by independent, qualified appraisers be obtained on all loans secured by real property. Appraisal requirements are set forth in Part 722 of the NCUARules and Regulations.

Member Business Loans. A member business loan is defined in Section 723 of NCUARules and Regulations as a loan which will be used for a commercial, corporate, business, or agricultural purpose. The regulation lists certain business loans which are excepted from the definition; among these is a loan, which, when added to other loans to a borrower or associated member (one with a common pecuniary interest in a business or commercial endeavor) totals less than $50,000. A credit union wishing to grant business loans must adopt and implement the written loan policies required by the regulation and address the considerations discussed therein. Because of the risks and complexities involved, management should control the program carefully and the board of directors should determine that the credit union's staff has the necessary credentials and qualifications.

Lines of Credit and Open-End Loans. A line of credit is a fixed amount of credit agreed to by the borrower and the credit union. The amount may be drawn upon from time-to-time and may be replenished by repayment of amounts previously drawn. The line of credit may be secured or unsecured. Some credit unions fashion lines of credit in combination with home equity loans. Access to the line of credit may be permitted by different methods, such as checks or cash disbursements, automatic teller machines, loan drafts, and plastic credit cards. Because advances are preapproved and readily accessible, line of credit borrowing is preferred by many consumers.

An open-end loan is similar to a line of credit plan. The primary difference is that advances are preapproved under the latter, while each open-end loan advance must be approved by a loan officer or the credit committee.

Guaranteed and Insured Loans. Federal credit unions may become qualified lenders under regulations established by various federal and state agencies which either insure or guarantee loans made to credit union members for purposes provided for in the insuring or guaranteeing programs. The most common types are residential real estate loans insured by the Federal Housing Administration (FHA), those guaranteed by the Veterans Administration (VA), and student loans insured under the Federal Insured Student Loan Program. A comprehensive listing of all available federal programs is published in the Catalog of Federal Programs which can be obtained from the U S. Government Printing Office. In order to participate in the various programs, a federal credit union should apply to the appropriate federal, state, or private insuring agency.

Financial Counseling

Often the first contact people have with a credit union is for the purpose of obtaining credit for assistance in solving their financial problems. In today's complicated and competitive lending market, people are frequently tempted by easily obtainable credit. While credit used wisely enhances the quality of life and is a major contributing factor to today's high standard of living, used unwisely, it leads to impulse buying and overextension.

Federal credit unions provide financial counseling services to assist members in managing their financial affairs effectively. The counseling program is usually under the stewardship of the credit committee or a loan officer. However, anyone having face-to-face contact with members, such as the financial officer or manager, may also be involved. Some credit unions engage professional consultants for this purpose.

Other Services

Federal credit unions provide other services to their members incidental to the basic purposes of promoting thrift and providing a source of credit. The ability of a credit union to offer such services depends on its expertise and its resources. Included among the services are the following:

- Check cashing.
- Sale of credit union checks, traveler's checks, and money orders.
- Collection of utility bills.
- Direct deposit of federal recurring payments.
- Automated teller machines.
- Insurance and group purchasing activities.
- Sale and redemption of U. S. Savings Bonds.
- Safe deposit box leasing.

Refer to Part 721 of NCUARules and Regulations with respect to requirements concerning insurance and group purchasing activities.

PART IV
Operational Requirements

Service Facilities

It is essential that a credit union establish an office readily accessible to its members. If space is not provided by the sponsor, the board of directors should obtain conveniently located space at a cost within the credit union's ability to pay. The board should also provide for the necessary office furniture and equipment.

Land and Building
A federal credit union has the power to acquire land and a building necessary and incidental to its operations. Before making a major investment of this nature, the board of directors should carefully analyze the need for the property and its potential impact on the credit union's earnings and overall financial condition. If real property is purchased for future expansion, it should be at least partially utilized within a reasonable period, unless otherwise approved by NCUA.

The purchase of land and a building is subject to the requirements and limitations set forth in Section 701.36 of NCUARules and Regulations.

Branch Offices
The board of directors may establish one or more branch offices in order to serve outlying members more effectively. Internal controls should be instituted; recordkeeping at the branch should be part of the centralized accounting system; and a communication system should be maintained between the offices.

Office Facilities on Military Installations

A federal credit union that has an office on a Department of Defense installation may have the option of using available space or constructing its own facilities. Authority for this activity is set out in Department of Defense Directive 1000.10, dated December 23, 1981.

Credit Union Service Contracts
A federal credit union may enter into a contract with one or more other credit unions or other organizations for the purpose of jointly owning, sharing, buying, selling, renting, or leasing fixed assets or engaging in credit union services or activities. For instructions and requirements concerning the terms of the contract, refer to Section 701.26 of NCUARules and Regulations.

Accounting System

The essential purpose of an accounting system is to provide a federal credit union's management with the complete and accurate financial information it needs to conduct sound and effective operations. The financial statements produced by the system are used by management to account to the members, creditors, and NCUA.

Section 2000 of the *Accounting Manual for Federal Credit Unions* spells out the prescribed accounting principles and standards that must be followed by federal credit unions. Adherence to these principles and standards will assure compliance with the full and fair disclosure provisions of Section 702.3 of NCUARules and Regulations.

The remainder of the accounting manual presents information, guidelines, and recommended procedures and practices for federal credit union officials and employees.

Employee Taxes

A federal credit union that pays salaries to one or more employees is subject to the provisions of law relating to withholding, remitting, and paying federal, state, and local taxes. These are:

a. Federal income tax.
b. State and local income taxes.
c. Social Security tax.
d. Federal unemployment compensation tax.
e. State unemployment compensation tax.

The Internal Revenue Service's Circular E, Employer's Tax Guide, obtainable from the local district director, will be of particular assistance.

Worker's Compensation

Many states require employers to carry worker's compensation insurance covering employees against loss of earnings if injured on the job. The credit union should get in touch with the appropriate state agency for information and instructions.

Surety Bond and Insurance Coverage

A federal credit union is required to obtain adequate surety bond coverage to protect it from direct losses resulting from dishonest and fraudulent acts of officials and employees and from losses such a theft and holdup caused by persons outside the credit union. Part 713 of NCUARules and Regulations prescribes the required minimum coverage and provides that the board of directors must review and determine the adequacy of the credit union's bond protection at least annually.

The board of directors also has the important responsibility of securing other insurance to protect the credit union's interest including fire, comprehensive, liability, and automobile insurance.

Records Preservation Program

A federal credit union is required to establish a records preservation program for the off-site storage of duplicate vital records which can be used for reconstruction purposes in the event of a catastrophe. The minimum requirements are prescribed in Part 749 of NCUARules and Regulations.

Security Program

Each federal credit union is required to institute a written security program in accordance with Part 748 of NCUARules and Regulations to protect the credit union from robberies, burglaries, larcenies, and embezzlements and to assist in the identification of persons who commit such crimes.

PART V
Management

The board of directors has responsibility for directing and controlling the affairs of the credit union and providing effective and efficient management of the credit union's operations.

Policies and Procedures

To carry out its responsibilities, the board should set realistic policies that are carefully designed to enable the credit union to function in a way that best serves the interests and needs of the membership. Comprehensive policies provide direction and instruction for officers, employees, and committees delegated the responsibility for implementing them.

The board should establish written policies that are: (1) firm and clear in purpose; (2) consistent with the credit union's objectives; (3) in compliance with the Federal Credit Union Act, NCUARules and Regulations, the bylaws, and other applicable laws and regulations; (4) in accordance with the needs of the membership; and (5) in keeping with sound business practices.

Policymaking is a continuing responsibility and policies should be reviewed, evaluated, and adjusted periodically in order to realize maximum value and benefits for the credit union.

Policy Statements and Control Records
A policy statement should be recorded in the minutes of the meeting at which the board acted and should be issued to all affected persons and committees. The board should maintain a "Policy Control Record" in the minute book, describing the policy and showing the date of adoption.

Program Management

Once policies and procedures are established, the board of directors is responsible for their implementation. The board should determine that:

a. The persons responsible for carrying out the policies and procedures are aware of their intent and the results to be accomplished.
b. Each policy statement includes a periodic reporting or feed-back system so that the board may evaluate and change those parts of a policy which are not achieving the intended results.
c. Coordination exists among the individuals assigned to implement the policies and procedures.

To achieve the desired results in directing the credit union's program, the board should practice three basic principles of good management: planning, organizing, and controlling.

Planning
Planning is the systematic arrangement of all the factors required to achieve the goals and objectives of the credit union's program. During the planning phase, the board should decide:

a. What is the objective?
b. What is the program's purpose?
c. When will the program start and when will it end?
d. Who will implement the program?
e. Is the program affordable?

Organizing
Organizing is the grouping of activities and individuals in the best possible relationships so that the planned work can be accomplished effectively and economically. After the planning process has been established, the board of directors should mobilize, organize, and direct the staff and members who will implement the plans. The board should keep all involved individuals informed of the program's status.

Controlling
The board should control the activities and special assignments given so that it may readily determine if the program plans are being followed according to established policies and procedures.

Effective and continual program control by the board helps to:

a. Prevent unauthorized actions that can hinder the financial growth and operations of the credit union.
b. Keep members informed of the credit union's progress.
c. Predict trends and forecast results.
d. Make information available for evaluating staff performances.
e. Provide data for considering new programs.
f. Assess effectiveness of programs in attaining objectives.

Administrative Management

Administrative management provides the internal controls necessary for operating the credit union's business effectively, and for detecting and preventing illegal and unauthorized acts against the credit union. Internal controls are checks and balances built into policies and procedures. Many internal controls are required by the Federal Credit Union Act, while others are developed out of daily experience.

Internal controls prescribed by law, regulation, or sound business practices include, among others, giving a statement of account to each member showing the record of the member's transactions with the credit union, and obtaining evidence from each borrower showing the receipt of funds for a loan.

Internal controls may be molded into the credit union's operating procedures by: (1) dividing duties so that no one person has sole control over any transaction and its recording; (2) establishing the flow of work so that one employee, acting independently, automatically verifies the work of another without necessarily duplicating any work already performed; and (3) providing physical and mechanical facilities that support the maximum level of accuracy and work output.

To assure sound personnel and operational management, the board should, in addition, provide for written:

a. Personnel policies.
b. Position descriptions for all employees.
c. Performance evaluations at least annually of all employees and top management.
d. Training program for officials and employees.
e. Screening process for new employees.

Establishment and maintenance of internal controls in a federal credit union are the responsibility of the board of directors. However, the supervisory committee should make a complete survey of the internal controls at least annually. Any weaknesses discovered by the committee should be reported to the board and the committee should follow up to see that the weaknesses are corrected.

At least five types of internal controls should be utilized by the board of directors to assure maximum levels of service, growth, and protection for the members. They are organization, budgetary, accounting, methods and procedures, and internal auditing.

Organization
Effective organization provides for the logical delegation of duties, responsibilities, and authority, and should be adapted to the size of the group. The Federal Credit Union Act and the bylaws establish the basic organization pattern for federal credit unions. As a credit union grows in size, further divisions of duties and responsibilities become necessary.

Internal control is attained through such organizational procedures as:

a. Approval of loan applications by a separate credit committee elected by the members or appointed by the board, or by a loan officer(s) appointed by the credit committee or the board.
b. The signing and countersigning of checks and notes by a person other than a disbursing officer.
c. Approval of membership applications by the board of directors, the executive committee, or the membership officer, rather than by the paid board officer, the financial officer, any assistant to the paid board officer or financial officer, or a loan officer.
d. Internal audits by a supervisory committee conducted completely independent of any official or employee.
e. Maintenance, by persons other than those handling the accounting records, of separate lists of accounts opened and closed for the information of the directors and supervisory committee.

The bylaws and the *Supervisory Committee Guide for Federal Credit Unions* contain other examples and information by which control is achieved through organization.

Budgetary
Planning is an essential part of the budgetary process. Management should review economic conditions and all phases of the credit union's operations, and set long-range objectives and short-term goals. Alternative plans to achieve these objectives and goals should also be designed.

Actual budgeting is only one step in budgetary control, however. The final and most important steps are measuring results against the budget, seeking explanations for variance, and determining that any necessary adjustments are made.

Accounting
Accounting control is concerned with the day-to-day functioning of the credit union office; the proper methods for handling members'transactions and recording them on the books and records; the receipt and disbursement of funds; and the preparation of financial statements which reflect financial position and the results of operation.

A properly designed accounting system achieves internal checks. It provides the board with data about the actual operations and indicates whether or not the credit union is being managed in accordance with the procedures and policies established by the board. The accounting principles and standards section of the Accounting Manual for Federal Credit Unions sets forth the standards by which accounting operations can be evaluated.

Methods and Procedures

Methods and procedures should be set up to assure that the business of the credit union will be carried on in an orderly manner.

When method and procedure controls are established, certain principles should be adhered to: (1) responsibility should be fixed; (2) no one person should handle a transaction from beginning to end; (3) employees who receive and disburse cash should not post to members' ledgers nor reconcile the bank statement with the cash account; (4) control devices on office equipment should be used to the maximum; and (5) all employees, including the financial officer or management official, should be required to take a vacation at least once each year.

It is realized that a small credit union with only one or two experienced employees may face difficulty in following principles (2) and (3). Possibly some of the month-end work, which provides a check and control over the daily work, could be done by the board officers. If this is not possible, the internal auditing function of the supervisory committee becomes especially important and it would be desirable for the committee to expand the scope of its internal audit. An alert credit union management team continually studies its methods and procedures in an effort to make them more efficient, economical, and effective in helping to reach objectives.

Internal Auditing

Internal auditing is the fifth type of internal control. As required by law, the supervisory committee functions as the internal auditing body of the credit union.

All audit and account verification reports are submitted to the board. These reports assist the board in determining if the other officials and the employees are functioning in the manner prescribed by the organizational, accounting, budgetary, and method and procedure controls.

Each year the supervisory committee must perform or cause to perform a comprehensive annual audit. In addition, the committee is responsible for causing the members' accounts to be verified not less frequently than once every 2 years. *The Supervisory Committee Guide for Federal Credit Unions* discusses the auditing and account verification procedures to be performed by the committee. The board of directors or the committee may not reduce the minimum standards set forth in the guide. However, additional audits or supplemental procedures may be instituted by the board or the committee.

By properly carrying out its responsibilities, the supervisory committee will help deter fraud, error, careless action, and willful violation of law, regulations, and policy. Although all fraud and error cannot be prevented, membership and general public relation problems will be kept to a minimum when irregularities are detected early. Also, the financial officer or management official and the employees will normally make a greater effort to keep the records in proper order if they know the supervisory committee will quickly detect careless action.

Financial Management

Effective financial management is the basis for meeting sound financial objectives. By properly utilizing credit union resources, good management balances the extension of credit union services with the achievement of safe and sound operations. It provides for a fair return to members in the form of well-designed services and reasonable dividends. At the same time, it allows for continued growth of the credit union and enhances and protects members'equity.

Financial management embraces a number of credit union programs. Of particular significance are the following:

Share Program. Share and share certificate accounts are the primary source of credit union funds. Meeting the members'thrift needs is a major consideration when share policies are established. The officials must also, however, weigh the cost of funds and match shares with assets of similar maturities. For example, if a credit union's assets are mostly in long-term loans, share policies should strive to offer share accounts and share certificate accounts with extended maturity and restricted withdrawal features. On the other hand, if a credit union's assets are mostly in short-term loans, the officials might offer just regular share accounts and short-term share certificates.

Realistic dividend policies should also be established. When setting dividend rates, the board should carefully consider the credit union's funding needs and market conditions. In the interest of sound financial management, the board should avoid increasing dividends in order to achieve rapid share growth. Such growth often results in excess liquidity which in turn can adversely affect earnings.

The board's recorded policies should set dividend periods, the dates when share purchases begin earning dividends, applicable penalties, and methods of computation for respective types of accounts.

Lending Program. A sound lending program is central to the achievement of a credit union's purpose. It enables a credit union to meet members'needs while at the same time achieving the board's financial objectives. A realistic approach should be taken in balancing members'needs with credit union resources. The program should take into account a credit union's share structure and funds flow, its short- and long-range goals and objectives, and local economic conditions. Consistent with all of these factors, lending policies should clearly reflect maximum limits on loans; limitations on loan maturities and repayment terms; acceptable collateral; and interest rates which are reasonably designed to meet the credit union's income needs.

Loan Collections. Collection of loans is a vital part of a lending program. Effective loan collection contributes to a credit union's ability to sustain loan services and to maintain a sound financial position. The board of directors should establish collection policies designed to keep loan delinquency to a minimum. While these policies may differ from one credit union to another, the following characteristics should be evident: prompt and accurate delinquent loan reporting to the board; timely and consistent follow-up actions; utilization of outside collection sources when internal efforts fail to produce results; and maintenance of collection records. While loan collections may be delegated to a committee or staff member(s), the board has the responsibility of exercising close control over the program.

Investment Program. A credit union may at times have funds in excess of its needs for loans to members. Investing of surplus funds is provided for by the Federal Credit Union Act and a sound investment program should be maintained by the board of directors. The scope of the program will depend largely on a credit union's size and the extent of its surplus funds. Investment policies should be reduced to writing and should address at least the following:

a**. Legality:** Investments must comply with Sections 107(7), (8), and (15) of the Act and Part 703 of NCUARules and Regulations. The board of directors is responsible for determining that they do.

b. **Safety, Liquidity, and Yield:** Sound investment policies assume a conservative approach in balancing safety, liquidity, and yield. In this connection, liquidity means the ability to respond quickly to anticipated and unanticipated shifts in the credit union's flow of funds. Very often investments with greater risks command greater yields. Safety and yield should be carefully weighed prior to undertaking any investment that could result in a loss to the credit union. If a brokerage firm is used, the board of directors should satisfy itself as to the reliability and financial soundness of the firm.

c. **Diversification:** A policy of diversification can be employed to minimize potential investment losses. Such a policy is particularly useful for credit unions that invest in marketable securities. The board's policies should clearly address diversification and specially note any limitations it may place on the types of investments, quantities, and maturities to be purchased.

d. **Accountability:** While the board may delegate specific investment authority to an executive committee, an investment committee, or a management official, the board remains responsible for controlling the overall investment program.

e. **FAS 115 - Classification of Securities:** This accounting standard requires a federal credit union to classify its securities holdings (debt and equity securities) in one of three categories after assessing its intent and ability with regards to those holdings. The classification categories are: (1) held-to-maturity; (2) available-for-sale; and (3) trading. The related fair value of those securities classified as either available-for-sale or trading must be assessed at least as the end of each dividend period (e.g., monthly, quarterly, semiannually, or annually). Sales and transfers out of the held-to-maturity category should be rare and any such transaction may raise questions about the appropriateness of the designation of other securities as held-to-maturity.

NCUAInterpretive Ruling and Policy Statement No. 98-2, dated April 1998, provides guidance for managing investment risks including market, credit, liquidity, operational, and legal risks. It also provides guidance for board and senior management oversight of investment activities and describes, in general terms, the risk management process.

Additional information about federal credit union investments and related accounting procedures may be found in NCUALetters to Credit Unions. Current investment information may also be obtained by using NCUA's Investment Hotline toll free at (800) 755-5999.

Borrowing

Borrowing is a means by which a credit union obtains additional funds on a temporary basis. Properly planned, borrowing can stimulate growth, help meet financial objectives through a period of tight money, and satisfy seasonal or other temporary needs. It should not be a substitute for an effective thrift promotion program or a stop-gap attempt to replenish funds. The board may delegate borrowing authority to the executive committee, financial officer, or general manager, but remains responsible for all borrowing by the credit union. It should establish borrowing policies which include the conditions under which borrowing may occur; the amount that may be borrowed under each condition; the interest that may be paid on the borrowed funds; and the repayment terms that will apply. The board's borrowing and repayment plans should be coordinated with all other aspects of financial management. For legal limitations on borrowing activity by a federal credit union, see Section 107(9) of the Act and Section 701.38 of NCUARules and Regulations.

Prompt Corrective Action / Net Worth

The NCUABoard must prescribe a system of prompt corrective action to resolve the problems of insured credit unions. Regulations addressing prompt corrective action will be effective August 7, 2000. The Federal Credit Union Act defines net worth categories for purposes of prompt corrective action. The categories are: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Complex credit unions will be subject to risk-based net worth requirements effective January 1, 2001. The credit union's net worth position should be sufficient to meet competitive pressure and adverse economic conditions as they arise. It should enhance the safety of the members'shares and keep pace with growth in credit union assets.

Funds Management

Also referred to as asset/liability management, funds management is the continuing arrangement and rearrangement of both sides of a credit union's balance sheet to obtain reasonable profits and provide for adequate liquidity and safety. It focuses on short-run adjustments of assets and liabilities to compensate for variations in the flow of funds. In the long run, a credit union's success depends on reconciling the different elements involved in obtaining and using funds. Since a credit union must have sufficient liquid assets to meet loan demand and share withdrawals, a funds management program is vital irrespective of the credit union's size.

The basis for applying funds management strategy is a thorough knowledge of the makeup of a credit union's field of membership; the nature of its assets and liabilities; and the economic and competitive environment in which it operates. Funds management techniques should be applied with a full understanding of the characteristics of the individual credit union. The following are considered essential elements of an effective funds management program: (1) regular evaluation of the credit union's asset and liability structure; (2) regular assessment of asset yields and liability costs; (3) adequate planning for current and future liquidity needs; and (4) an on-going determination that policies are sufficient to efficiently structure assets and liabilities in order to meet changing economic conditions.

A necessary ingredient for sound financial management is a workable management information system. Reports containing basic financial information should be prepared and reviewed on a regular basis. Report formats and content will vary from one credit union to another, depending on the characteristics of each and its funds management methods.

The reports should, however, contain at least the following information:

a. Budgetary projections of income, expenses, and profitability.
b. Asset yields and liability costs.
c. Liquidity needs and sources of funds available to meet those needs, including the remaining maturities of all assets and liability accounts.

d. Economic and competitive conditions in the credit union's market area.

Financial Performance Report (FPR)
NCUA's Financial Performance Report (FPR) provides a long-term picture of the credit union's financial trends and operating results. This data can be used by the board of directors to identify key trends, analyze past performance, and set future goals.

FPRs are computer-generated reports prepared from data that the credit union has submitted to NCUAfor the previous 5 years. Data is updated twice each year (June and December) from the Call Report (NCUA5300) for all credit unions, and quarterly (March, June, September, and December) for credit unions over $50 million in assets. Data is presented in the form of ratios, statistics, and dollar amounts. FPRs also portray the credit union in relation to a credit union peer group of similar asset size. This is accomplished through utilization of peer averages and percentile rankings.

A more detailed discussion of the FPR can be found in the User's Guide for NCUA's Financial Performance Report F-P-R (NCUA8008).

Part VI
NCUA Funds and Programs

National Credit Union Share Insurance Fund

The National Credit Union Share Insurance Fund (NCUSIF) was established by Congress in October 1970 for the purpose of insuring share deposits in member credit unions. Unlike the Federal Deposit Insurance Corporation (FDIC), the NCUSIF was launched without the benefit of appropriated or taxpayer monies. The Fund, an arm of NCUA, is managed under the direction of the three-person NCUABoard, and is audited annually by an independent accounting firm.

Share deposits in federally insured credit unions are insured up to $100,000, an amount equal to the insurance protection offered by the FDIC. Generally, if a credit union member has more than one account in the same insured credit union, those accounts are added together and insured up to $100,000. However, there are exceptions to this rule. NCUAPublication 8046, *Your Insured Funds*, explains the various types of member accounts and the insurance coverage afforded on each account, and answers questions most frequently asked about the Fund. Credit unions which are insured by the NCUSIF are required to display the official blue and white NCUAinsurance sign at the teller windows. All federal credit unions must be insured by the NCUSIF. No federally insured credit union may terminate its insurance without the written approval of the NCUABoard and an affirmative vote by a majority of the members. Sections 205 and 206 of the Federal Credit Union Act and Part 708 of NCUARules and Regulations spell out the exact steps to be taken.

The NCUSIF is funded through its member credit unions. Federally insured credit unions are required to maintain in the Fund a deposit equal to 1% of their insured shares. This deposit is carried as an asset on the credit union's financial statements and may earn a dividend if the Fund exceeds its normal operating level ratio of 1.30% during the insurance year. In addition to the deposit, an annual insurance premium equal to 1/12th of 1% may be assessed. Monies collected from credit unions are primarily invested in U S. Treasury securities and the income earned is used to offset all administrative and insurance costs of the Fund. Any remaining income after payment of these costs is allocated to Fund equity to maintain the operating level ratio at or close to the 1.30% range.

The Federal Credit Union Act also authorizes the NCUSIF to grant assistance to problem credit unions in order to avoid involuntary liquidation. Under Section 208 of the Act, the NCUSIF may make loans to, purchase assets of, or establish accounts in such insured credit unions.

For further information about the NCUSIF, refer to Title II of the Act, Parts 740, 741, and 745 of NCUARules and Regulations.

Central Liquidity Facility

Congress has created the Central Liquidity Facility (CLF) within NCUAto improve general financial stability by providing credit unions with a source of loans to meet their liquidity needs such as banks and savings and loan associations have available to them through the Federal Reserve System and Federal Home Loan Banks. This works to encourage savings, support consumer and mortgage lending, and provide basic financial resources to all segments of the economy.

The CLF provides loans to meet unexpected share outflows, seasonal needs, and needs arising from emergencies such as strikes, plant closings, and local or national economic difficulties, when funds may not be available from other sources. It is not necessary to show that a loan has been rejected elsewhere, nor will the credit union have to liquidate investments. The credit union must not be insolvent or failing and must be creditworthy. The CLF is designed to provide funds for liquidity purposes only, not to expand lending.

A credit union may join the CLF directly as a regular member or through a corporate credit union that is an agent member of the CLF. To become a regular member, a credit union must invest 1/4 of 1% of its paid-in and unimpaired capital and surplus in the CLF. An additional 1/4 of 1% is on call and must be kept in liquid form. There is no capital subscription requirement for membership through an agent; however, an agent must meet the investment and on-call requirements for each of its member credit unions and will probably require reimbursement from the borrowing credit union.

Additional information about the CLF may be found in Title III of the Federal Credit Union Act, Part 725 of NCUARules and Regulations. A credit union may also call the CLF at (703) 518-6360 with questions on loans and membership.

Community Development Revolving Loan Program for Credit Unions

The Community Development Revolving Loan Program for Credit Unions (Part 705 of NCUARules and Regulations) enables both federal and state-chartered credit unions meeting certain qualifications to apply for and receive loans of up to $300,000 at a low fixed interest rate. Participating credit unions must serve a predominantly low income member base and provide basic financial and related services to the members in the communities they serve. Loans received by participating credit unions from the revolving loan fund must be matched, dollar for dollar, by increased shares in the credit union within 1 year of the approval of the loan application and must maintain the increase in the total amount of share deposits for the duration of the loan. All loans must be repaid in full within 5 years so that the loan funds may be redistributed to other participating credit unions.

Ombudsman Program

The duties and responsibilities of the Ombudsman (NCUAemployee appointed by the Chairman and not in a program position) are to receive, review, and investigate external complaints of a regulatory nature unresolved at the operational level. Solutions are recommended since the ombudsman does not have independent decision-making authority. Correspondence should be addressed to the Ombudsman, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314-3428.

Part VII
Other Laws Affecting Federal Credit Unions

This part of the Handbook briefly discusses the laws and regulations other than the Federal Credit Union Act and NCUARules and Regulations which contain requirements that may affect the day-to-day operations of federal credit unions. The officials of a federal credit union have the responsibility of being aware of the provisions of these laws and regulations and determining that the credit union complies..

Consumer Laws and Regulations

Truth in Savings Act
This Act requires all credit unions to disclose fees, dividend (or interest, if applicable) rates and other terms concerning accounts to members or potential members before they open accounts. The law also requires that periodic statements be provided to members and include information about fees imposed, dividends (or interest, where applicable) earned and the annual percentage yield earned on those statements. Limitations on the methods used by credit unions to determine the balance on which dividends are calculated and rules dealing with advertisements for accounts are also included in the law.

Truth in Lending Act, Regulation Z
The purpose of this regulation is to promote the informed use of consumer credit by requiring disclosures about its terms and conditions. The regulation requires very specific information to be disclosed for both open-end and closed-end loan plans. Credit unions that do not comply may be subject to civil liability as provided for by Section 130 of the Truth in Lending Act. This regulation is applicable only to extensions of consumer credit, i.e., credit offered primarily for personal, family, or household purposes.

Equal Credit Opportunity Act, Regulation B
Under this regulation, no creditor may discriminate on a prohibited basis in any aspect of a credit transaction. The prohibited bases are: race, color, religion, national origin, sex, marital status, age, receipt of income from any

pubic assistance program, or good faith exercise of rights under the Consumer Credit Protection Act. The regulation addresses what information may be requested on loan applications, how it may be considered, and the content of notices required to be given following the action taken on loan applications. As with the Truth in Lending Act, the Equal Credit Opportunity Act contains a civil liability provision to protect the consumer against noncompliance by the credit union.

Electronic Fund TransferAct, Regulation E

This regulation affords protection to members whose share accounts may be accessed through the use of an electronic terminal, telephone, or computer or magnetic tape, without the use of any paper instrument to initiate the transaction. The regulation requires disclosure of the terms and conditions applicable to such activity as well as documentation of such transfers and procedures for resolving errors within a specific time frame.

Preservation of Consumers'Claims and Defenses Rule

This Federal Trade Commission rule, better known as the "Holder in Due Course" rule, is intended to prevent sellers and creditors from unjustly separating the consumer's responsibility to pay for goods and services from the seller's obligation to deliver marketable goods or otherwise perform its obligations. It applies when the credit union is both the seller and the lender, as in the case of repossessed property sold to a member and financed by the credit union, as well as when the credit union has a formal or informal business arrangement with the seller to offer the financing on its merchandise.

Fair Credit Reporting Act

Credit unions are subject to the requirements of this Act when information obtained from a consumer reporting agency contributes to the denial of the applicant's loan request. The name and address of the reporting agency must be disclosed. When information obtained from a source other than a consumer reporting agency is used, the applicant must be told of the right to request, in writing, the nature of the information.

Real Estate Settlement Procedures Act (RESPA), Regulation X

To protect consumers, this regulation requires that home buyers be provided with certain specific information relating to financing and settlement costs of residential real estate transactions within 3 business days of submitting a mortgage loan application and at the time of settlement.

Fair Debt Collection Practices Act

A credit union is subject to this Act only if it regularly collects consumer debts on behalf of another party, with some exceptions. Various collection practices are prohibited such as harassment, intimidation, threats, and humiliation. If a credit union merely collects its own debts, in its own name, compliance with this Act is not required. However, it is recommended that the credit union avoid those practices prohibited under the Fair Debt Collection Practices Act.

Home Mortgage Disclosure Act, Regulation C
This Act requires credit unions to disclose publicly where their mortgage loans have been granted. Its purpose is to prevent lenders from ruling out or "redlining" certain residential areas of a city as ineligible for mortgage credit. It does not prohibit the creditor from determining the value of the collateral in relationship to the amount of credit requested.

Other Laws and Regulations

Bank Bribery Amendments Act
As required by the Bank Bribery Amendments Act, NCUAhas established guidelines to assist the officials of federally insured credit unions in complying with that law. Consistent with the intent of the Act, to proscribe corrupt activity in credit unions, the guidelines prohibit any employee, officer, director, committee member, agent, or attorney from:

a. Soliciting for themselves or a third party (other than the credit union) anything of value from anyone in return for any business, service, or confidential information of the credit union.
b. Accepting anything of value (other than bona fide salaries and fees) from anyone in connection with the business of the credit union either before or after a transaction is discussed or consummated.

The guidelines encourage all federally insured credit unions to adopt written codes of conduct or policies explaining the prohibitions in the law. These codes or policies can desirably be included with those dealing with other areas of conduct such as conflicts of interest, discussed in Part VIII.

Credit unions are urged to review NCUAInterpretative Ruling and Policy Statement No. 87-1, dated October 16, 1987, for a full discussion of the prohibitions and guidelines.

Currency and Foreign Transactions Act
The purpose of the Currency and Foreign Transactions Act (Bank Secrecy Act) is to require certain recordkeeping and reporting which are useful in criminal tax or regulatory investigations or proceedings. Generally, the Act and United States Treasury’s implementing regulations require a credit union to maintain certain records and to file certain reports with the Internal Revenue Service or U. S. Customs Service.

As directed by Congress in the Anti-Drug Abuse Act of 1986, NCUAhas adopted a regulation, Section 748.2, requiring federally insured credit unions to set up programs for compliance with the recordkeeping and reporting obligations of the Currency and Foreign Transactions Act and Department of Treasury regulation 31 C.F.R. Part 103. In its Letter to Credit Unions No. 90, dated May 19, 1987, NCUAhas spelled out guidelines to assist credit unions in complying with the requirements of its regulations. That letter also summarizes the recordkeeping and reporting requirements of the Treasury regulation.

Internal Revenue Service Publication 1148 provides additional information and may be obtained with the required report forms from any Internal Revenue Service Office. NCUAadvises all federal credit unions to consult legal counsel regarding compliance.

Flood Disaster Protection Act

The Flood Disaster Protection Act of 1973 (FDPA) and Part 760 of the NCUA Rules and Regulations prohibits federally insured credit unions from making, increasing, extending, or renewing any loan secured by improved real estate or a manufactured home if:

a. The property securing the loan is located in an area having special flood, mudslide or flood-erosion areas, as identified by the Federal Emergency Management Agency (FEMA);
b. The community is participating in the National Flood Insurance Program (NFIP); and
c. Insurance is not purchased for the property securing the loan.

The principal objectives of the FDPA are to ensure that flood insurance is available at reasonable cost and to reduce or avoid future flood losses and provide a preventive alternative to massive doses of federal disaster relief funds normally made available to flood stricken areas.

Right to Financial Privacy Act

The Right to Financial Privacy Act protects the personal financial privacy of federal credit union members by restricting access to a credit union's financial records concerning its members.

The Act sets forth the conditions that must be met before a credit union may grant access to or provide copies of financial records of a member to a government authority. In most cases, the credit union must obtain authorization from the member or secure from the government authority a subpoena or summons, a search warrant, a judicial subpoena, or a formal written request.

Under the Act, a credit union may disclose to a government authority that it has information relevant to a possible violation of any statute or regulation, giving only identifying information and the nature of any suspected illegal activity. The Act provides that the credit union or any official, employee, or agent is not liable to the member for making such disclosure or failing to notify the member thereof.

The provisions of the Right to Financial Privacy Act should be reviewed in detail before any disclosure is made.

Soldiers' and Sailors' Civil Relief Act

Since persons entering military service sometimes do so at greatly reduced income, they may be unable to meet the terms of obligations they made while in civilian life. The Soldiers' and Sailors' Civil Relief Act provides protection during the period of reduced income. The Act does not cancel obligations but merely gives to those in military service who are financially unable to pay, protection against legal action to repossess collateral or force payment of an obligation.

The Act applies only to loans made prior to entering the service. It does not prevent a credit union from accepting loan payments or from continuing loan collection efforts short of legal steps.

The Act should be consulted for its application to the operation of a credit union. If any legal action against a borrower in military service is felt justified and necessary, the advice of local counsel should be obtained.

Fair Housing Act

The Fair Housing Act prohibits a credit union from denying a mortgage or home improvement loan to any member for reasons of race, color, religion, sex, or national origin. Requirements and guidelines are set forth in Part 701.31 of NCUA Rules and Regulations.

Privacy Act

The Privacy Act protects individual privacy. The Act applies to the Federal Government's collection, maintenance, and use of information about individuals.

The Privacy Act may affect those federal credit unions whose sponsors are federal agencies or instrumentalities, but only in a limited way. While a federal agency (with the exception of agencies like the CIA) may routinely release the name, position, title, base pay, GS level, and duty station of an employee, the federal credit union may need to obtain its member's consent if it wants to secure additional information from the agency, for example, in connection with determining a loan applicant's creditworthiness.

Government Securities Act of 1986

The Government Securities Act and its implementing regulations pertain to the following activities and duties of brokers and dealers in government securities: financial responsibility, protection of investor securities and funds, recordkeeping, and reporting and audit. The regulations also apply to the custody of government securities held by depository institutions. The Act does not significantly affect credit unions. However, credit unions that: (1) engage in reverse repurchase transactions in which they retain custody of securities subject to the repurchase transaction, or (2) offer members self-directed IRA plans in which the credit union will hold any securities purchased by the member, should consult the applicable provisions of the implementing regulations.

Abandoned Property Laws
Many states have laws requiring the transfer of inactive deposit accounts to the respective state. The credit union should consult the appropriate state agency regarding requirements and procedures.

Federal Election Campaign Act
The Federal Election Campaign Act prohibits federally chartered corporations (including federal credit unions) from contributing to political campaigns. However, the Federal Election Commission Rules and Regulations permit a trade association to solicit from a credit union's members if:

a. The credit union has separately and specifically approved the solicitation; and
b. The credit union has not approved a solicitation by any other trade association during the calendar year.

If these conditions are met, a federal credit union may disseminate to its members political information prepared by the trade association.

Federal credit unions may not make share withdrawals for members for payments to a third party as political contributions. Doing so would constitute a donation of time and resources by the credit union and is prohibited.

Management Official Interlocks
Under the Depository Institution Management Interlocks Act, a management official of a depository institution or depository holding company is prohibited from also serving as a management official of another depository institution or depository holding company if the two organizations are not affiliated and are very large or located in the same local area. Part 711 of NCUARules and Regulations discusses the prohibitions as they apply to federally insured credit unions.

Regulation G
A credit union that grants loans secured by margin securities is subject to the provisions of Regulation G.

Expedited Funds Availability Act, Regulation CC
Regulation CC regulates funds availability policies, endorsement standards, and collection and return policies on checking, share draft, and other transaction accounts. It also establishes the date on which dividend credit must be given on a deposit item. Credit unions offering transaction accounts to members must fix and disclose their funds availability policies. The regulation provides specific timetables within which funds deposited in the credit union must be made available. All checks and share drafts must also adhere to a closely defined endorsement method. The placement and content of the endorsement are defined specifically in the regulation.

Part VIII
Conflict of Interest

Federal credit union officials and employees have an obligation to the credit union that extends beyond assuring that their actions do not violate any statute or regulation. They are fiduciaries who owe it to the credit union to act in good faith in the performance of their duties.

In accepting a position as an official or employee of a federal credit union, an individual should recognize that the interests of the credit union and its members have priority over any personal interest that individual may have. The position should not be used to gain personal profit or advantage. Acceptance of a position involves the assumption of fiduciary responsibilities, some of which are set forth in the Federal Credit Union Act, NCUARules and Regulations, Federal Credit Union Bylaws, and state laws; others, such as the duty to exercise due care and diligence, stem from common law.

Article XIX, Section 4 of the bylaws provides that no official, employee, or agent may in any way act on any matter affecting that person's monetary interest or that of an entity in which she or he is interested.

NCUARules and Regulations prescribe the following prohibitions with respect to conflicts of interest.

Section 701.21(c)(8)
A loan may not be made or line of credit extended if, either directly or indirectly, any commission, fee, or other compensation is to be received by an official, senior management employee, loan officer, or any immediate family member of such individual, in connection with underwriting, insuring, servicing, or collecting the loan or line of credit.

Section 701.21(d)(5)
An official, immediate family member, or other person having a common ownership, investment, or other pecuniary interest in a business enterprise with an official or immediate family member may not obtain a loan or line of credit with preferential rates, terms, or conditions, or act as guarantor or endorser thereon.

Section 701.36(e)
A federal credit union may not buy or lease premises (with the exception of an informal lease maturing in less than a year) from any of the following without the prior written approval of NCUA:

a. An official or senior management employee or immediate family member of such person.
b. A corporation in which any of the above-named persons is an officer or director or has a stock interest of 10 percent or more.
c. A partnership in which any of the above-named persons is a general partner or a limited partner with an interest of 10 percent or more.

Section 703.120
A federal credit union's officials, senior management employees, or their immediate family members may not receive any payment in connection with the making of an investment or deposit.

Section 712.8(a)
When a federal credit union has invested in or made loans to a credit union service organization, the credit union's officials, senior management employees, or their immediate family members may not receive any salary, commission, investment income, or other compensation from the organization either directly or indirectly, or any person being served through the organization. The official or senior management employee may assist in operating the organization if compensation is not involved; the organization may, however, reimburse the credit union for services provided by the individual.

Section 721.2(c)
Afederal credit union's officials, senior management employees, or their immediate family members may not receive any direct or indirect compensation or benefit in connection with the credit union's insurance or group purchasing activities. The prohibitions in Sections 712.8(a), 701.36(e), 703.120, and 721.2(c) apply to any employee not otherwise covered in the regulations unless the board of directors determines that no conflict of interest is involved in the respective cases. Where prohibitions are not specifically stated regarding transactions with business associates or family members, officials should exercise care that such transactions are conducted at arm's length and in the best interest of the credit union.

Section 723.2(a)
A federal credit union may not make member business loans to the following nonvolunteer senior management employees or to any associated member or immediate family member of such employees:

a. Chief executive officer (typically president or treasurer/ manager).
b. Any assistant chief executive officer (e.g., assistant president, vice president, or assistant treasurer/manager).
c. Chief financial officer (comptroller).

Other

A number of federal criminal statutes apply to federally insured credit unions. Federal credit union officials and employees have the responsibility to report suspected criminal activities to the appropriate law enforcement agencies on NCUAForm 2362 (Suspicious Activities Report). See Section 748.1 of NCUA Rules and Regulations.

The Federal Credit Union Act gives the board of directors responsibility for the general direction and control of the credit union. The board thus has the task of establishing policies and procedures for the conduct of the credit union's affairs, including the establishment and monitoring of investment and lending policies and appropriate dividend rates.

The board of directors should select competent management to carry out policies and procedures and monitor its performance. The board should strive to retain the best qualified personnel at rates most favorable to the credit union. While the salary and benefits offered to secure competent management will vary in each case, the directors should avoid contracts which might threaten the safety and soundness of the institution. Bonuses tied to increases in asset growth or income could have such an effect. They create an incentive for management to act in its own interests rather than those of the credit union.

The supervisory committee shares the board of directors'responsibility for determining that management practices are protecting the members'assets; that the board's policies and procedures are being administered properly; and that safeguards exist against fraud and conflict of interest.

NCUAencourages boards of directors of federal credit unions to establish codes of conduct to guide officials and employees in avoiding conflicts of interest. All should shun actions from which they would derive personal gain from the business of the credit union, other than normal salaries, benefits, and permissible nonpreferential loans.

Part IX
Other Procedures and Supplemental Information

Mergers

Mergers of credit unions are usually effected for the purpose of continuing or improving service to members.

A federally insured credit union may merge with one or more credit unions provided they comply with the requirements set forth in Part 708 of NCUA Rules and Regulations and secure the prior approval of NCUA. If one of the credit unions is state-chartered, the merger must also be authorized by the state supervisory authority or permitted by state law. The regulations also prescribe procedures to be followed if termination of federal insurance or conversion of federal insurance to nonfederal insurance are involved.

NCUApublication *Credit Union Merger Procedure and Merger Forms* (NCUA8056), provides detailed instructions and contains the required forms.

Conversions

A federal credit union may convert to a state-chartered credit union under the provisions of Section 125 of the Federal Credit Union Act. If the conversion involves termination of federal insurance or a change from federal insurance to non-federal insurance, the requirements outlined in Subparts B and C of Part 708 of NCUARules and Regulations must be met.

The Act also provides for conversion of a state-chartered credit union to a federal credit union and recites the relevant requirements.

As pointed out in the Act, the conditions set forth in state law and by the state supervisor must be met in either type of conversion.

Liquidation-Voluntary and Involuntary

Should it become necessary for a federal credit union to liquidate, the liquidation is conducted in accordance with the requirements of Part 709 (involuntary liquidation) or Part 710 (voluntary liquidation) of the NCUARules and Regulations. As guidance for the board of directors in managing a voluntary liquidation, the NCUAmanual *Voluntary Liquidation Procedure for Insured Federal Credit Unions* (NCUA8040) is provided by the regional director. The major responsibility of the board is to conduct the liquidation in such a manner that the interests of the members, the insurance fund, and the creditors of the credit union are safeguarded. If the board anticipates selling the credit union's loans but the bids of prospective purchasers will not provide sufficient funds to pay off shareholders at par, no sale may be consummated without written approval from NCUA. If the credit union becomes insolvent during liquidation, the NCUABoard may either provide assistance under Section 208 of the Federal Credit Union Act and restore solvency or place the credit union into involuntary liquidation and pay out the members, depending on the circumstances. The same alternatives apply when an operating credit union becomes insolvent.

Whereas a voluntary liquidation is conducted by a federal credit union's board of directors and shares are paid to members from the credit union's resources, an involuntary liquidation is supervised by NCUAand the members'shares are paid directly from the National Credit Union Share Insurance Fund up to the $100,000 insurance limit. Except in unusual cases, payout from the Fund is begun promptly following commencement of involuntary liquidation.

Credit Union Trade Associations

Local, state, and national trade associations promote the interests of the credit union industry. They offer a variety of services to their members, pursue the enactment and promulgation of, and changes in legislation and regulations, and represent credit union interests before NCUA, state legislatures, and the United States Congress.

The decision to join a trade association and approve expenses incidental to membership and participation rests with a federal credit union's board of directors.

Corporate Credit Unions

The Federal Credit Union Act authorizes federal credit unions to invest in shares, deposits, and certificates of corporate credit unions, federally or state-chartered. A corporate federal credit union is defined in Part 704 of NCUA Rules and Regulations as one that operates primarily to serve other credit unions and limits natural person members to the minimum required by state or federal law to charter and operate the credit union.

Corporate credit unions offer daily-balance share accounts which can earn dividends comparable to market rates offered by other financial institutions. Corporate credit unions also offer a variety of other investment accounts. In addition, many corporates offer accounts for clearing share drafts and credit card activity.

Credit Union Service Organizations

Credit union service organizations (CUSOs) are organizations that provide operational and financial services primarily to credit unions and the membership of affiliated credit unions.

The CUSOs in which federal credit unions may invest or to which they may make loans are limited by the Federal Credit Union Act to providing services associated with the routine operations of credit unions. The kinds of services they may offer are specified in Section 712.5 of NCUARules and Regulations. Examples are credit card services, automated teller machine services, and debt collection services.

A federal credit union may, by itself or with other credit unions form, invest in, or make loans to one or more CUSOs. Investment is limited to a total of 1 percent of the credit union's paid-in and unimpaired capital and surplus in the shares, stock, or obligation of the organization(s). Loans may not exceed 1 percent of the credit union's paid-in and unimpaired capital and surplus (independent of the 1 percent investment limit).

A CUSO must be structured as either a corporation or a limited partnership. A credit union must obtain written legal advice as to whether the CUSO is set up in a manner that will limit the credit union's potential exposure to no more than the loss of funds invested in or loaned to the CUSO. The credit union must, in addition, secure written agreements that the organization will follow generally accepted accounting principles; render financial statements and obtain a certified public accounting audit annually; and provide NCUAwith complete access to the CUSO's records as deemed necessary by the NCUA Board in carrying out its responsibilities under the Federal Credit Union Act.

Part 712 of NCUARules and Regulations should be reviewed in detail before a federal credit union invests in or lends to a CUSO.

Member's Right to Inspect Credit Union Record

A member has the right to inspect a federal credit union's books and records, including the board of directors' minutes. The inspection must be made in good faith and for a proper purpose. It can not be to satisfy mere curiosity or for vexatious purposes.

A proper purpose exists where a member is trying to determine financial condition of the credit union or ascertain the manner in which the credit union's business is being conducted. Before making minutes and records available, however, the credit union must delete any confidential material that identifies the transactions of or personal information about other members.

National Credit Union Administration Publications

The NCUA publications referred to in this Handbook and other NCUA publications may be purchased from NCUA's Administrative Office at 1775 Duke Street, Alexandria, VA 22314-3428. The cost of a publication and a copy of a price list may be obtained by writing that office or calling (703) 518-6340. Many of NCUA's publications are on our Internet Web Site at http://www.ncua.gov.

Single copies of new publications and changes are forwarded to all federally insured credit unions.

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